

Texas Water **Development Board**

Review of Compliance with the Public Funds Investment Act

Debt Portfolio Management Division
Project #2016.05
January 2016

Executive Summary

We reviewed fiscal years 2014 and 2015 investment activities to determine whether agency processes ensure compliance with the requirements of the Public Funds Investment Act (Texas Government Code, Chapter 2256) and the Texas Water Development Board (Board) investment policy.

Overall, we found that the agency complied with most of the requirements outlined in the Act. The agency's written investment policy is reviewed and approved by the governing board, and includes separate investment strategies for each of the funds managed by the Board. In addition, quarterly reports on investment activities were prepared and presented to the Board, and training sessions were attended by governing board members, Investment Officers, and investment staff.

However, we noted areas in which improvements should be made to strengthen management controls over investment activities and ensure full compliance with the Act. These improvements include updating the investment policy, ensuring the appropriate investment training is attended timely, tracking deadlines for key deliverables, and establishing a review process to ensure quarterly investment reports are accurate and complete. Management controls should be further strengthened by ensuring the contractual agreement between the agency and the Texas Treasury Safekeeping Trust Company (TTSTC) is periodically reviewed and approved by the Board.

House Bill 4 (83rd Legislature, Regular Session), effective September 2013, reorganized the leadership structure of the agency by transitioning the six-member, part-time Board to a three-member, full-time Board. Since then, a concerted effort was made to streamline agency activities and processes. During this period of organizational restructuring, the agency experienced turnover of key staff positions in the program area under review, resulting in a loss of institutional knowledge that may have ultimately impacted the effective implementation of existing policies and procedures.

Consistent application of established controls, in addition to minor policy and procedural changes as addressed in the report, should enhance the overall effectiveness of the agency's investment activities.

Background

The Public Funds Investment Act (Act) governs the investment of government funds in Texas. The Act requires certain state agencies, universities, and local governments to arrange for a biennial compliance audit of management controls on investments and adherence to the entity's established investment policies, for those funds the entity is authorized to invest. Texas Water Development Board (TWDB) investment policy assigns the responsibility for performing this audit to the Internal Audit Division. The results of the audit must be reported to the State Auditor's Office (SAO).

TWDB investment policy also designates the Chief Financial Officer and the Executive Administrator as the agency's Investment Officers. The Investment Officer is responsible for the investment of funds consistent with the investment policy. The Debt and Portfolio Management

(DPM) Division, organizationally located within the Finance Office, is responsible for monitoring and reporting on the Board's investment activities.

In December 2006, TWDB approved the selection of the TTSTC to act as investment advisor to the Board and to Texas Water Resources Finance Authority (TWRFA) and to provide funds management and investment services.

As of August 31, 2015, TWDB had an investment portfolio of approximately \$948 million for those funds managed by the Board, the largest component of which was invested in repurchase agreements. These investment resources represented the various funds and accounts maintained by the Board and TWRFA in administering its financial assistance programs.

Audit Objectives, Scope, and Methodology

Objectives

The objective of the audit was to review the agency's investment activities to determine whether processes ensure compliance with the requirements of the Public Funds Investment Act (Act) and TWDB's investment policy. This included:

- Determining whether policies and procedures complied with the Act, and such policies and procedures were appropriate and reasonable for the agency's investment types and investment goals; and
- Determining whether internal controls over investments were sufficient to safeguard assets, ensure proper conduct by participants in the investment process, and eliminate conflicts of interest.

Scope and Methodology

The scope of the audit covered fiscal years 2014 and 2015 (September 1, 2013 to August 31, 2015) and was limited to funds managed by the Board.

The methodology for the audit consisted of a review of the following documentation:

- The Public Funds Investment Act (Texas Government Code, Chapter 2256).
- The TWDB investment policy, internal procedures, and Board minutes.
- The Funds Management and Investment Agreement between the TWDB and the TTSTC.
- Quarterly investment reports.
- Investment training records, materials, and certificates of completion.
- Biennial compliance audit and the annual review of quarterly investment reports.
- Annual investment disclosure forms.

Tests and procedures included the following:

- Conducting interviews with management and staff.
- Determining whether the investment policy included the elements required by the Act.
- Determining whether the quarterly investment reports included the specific components required by the Act.
- Reviewing the quarterly investment reports for adherence to strategies, restrictions, controls and objectives, as defined in the TWDB investment policy.
- Reconciling the quarterly investment reports to the investment transaction detail and holdings data to determine accuracy.
- Selecting a sample of investment transactions and validating that controls ensured assets were properly processed, safeguarded, and reported.

This audit was conducted in accordance with *Generally Accepted Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing*. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

The audit team consisted of:

Yania Munro, CGAP
Nicky Carter, CICA
Nicole Campbell, CIA, CISA

Results and Recommendations

Overall, we found that the agency complied with most of the requirements outlined in the Act and the investment policy. However, we identified opportunities to improve management controls and strengthen compliance by enhancing existing policies and procedures, and broadening the agency's oversight activities.

No.	Observations	Recommendations
1	<p>The written investment policy complied with the key requirements of the Act; however, it did not include a statement for pooled fund groups as to the maximum dollar weighted average maturity, as required by Texas Government Code, Section 2256.005 (b)(4)(C). TWDB's pooled fund group consists of the State Revolving Fund (SRF), Water Development Fund (Dfund), and TWRFA.</p>	<p>The investment policy should be updated to include a statement for pooled funds groups as to the maximum dollar-weighted average maturity allowed based on the stated maturity date for the portfolio.</p> <p>Managements Response: <i>Management agrees. The Investment Policy is currently being updated and recommendations will be presented to the Board in March.</i></p> <p>Person Responsible: Cindy Demers Implementation Date: March 31, 2016</p>
2	<p>In reviewing for compliance with Texas Government Code, Section 2256.007, we verified that each Board member and each Investment Officer attended at least one training session relating to their responsibilities under this chapter within six months after taking office or assuming duties. We also verified that investment staff had attended training, as required by TWDB investment policy. We noted:</p> <ul style="list-style-type: none"> (i) One Investment Officer had not attended training within the required timeframe, in accordance with Texas Government Code, Section 2256.007(a). Additionally, the training session was related to the duties and responsibilities of governing board members, and was not intended for Investment Officers. (ii) One staff member did not attend a training session during the required time period, as prescribed by Section VII, TWDB investment policy. (iii) Documentation was not available to verify that the Investment Officer had provided a report to 	<p>Written internal procedures, and the investment policy as necessary, should be updated to address the requirements outlined in Texas Government Code, Section 2256.007. This should include, at a minimum ensuring that:</p> <ul style="list-style-type: none"> (i) Each Investment Officer and investment staff should attend the appropriate training within the required timeframe. (ii) A report on training activities is provided to the Board, and documentation is retained. <p>Managements Response: <i>Management will update the Investment Policy to reflect a requirement that Investment Officers will receive at least one training session within 6 months of assuming duties, and at least once per biennium, as required by the Act.</i></p> <p><i>Management will develop a written system to track the required training, and will update written procedures to incorporate regular</i></p>

No.	Observations	Recommendations
	<p>the Board on training activities, as required by Texas Government Code, Section 2256.007(d).</p>	<p><i>reporting on training activities in the quarterly investment reports.</i></p> <p>Person Responsible: <i>Cindy Demers</i> Implementation Date: <i>March 31, 2016</i></p>
3	<p>Overall, we found that the quarterly reports for fiscal year 2015 complied with most of the requirements outlined in Texas Government Code, Section 2256.023, with the following exceptions:</p> <ul style="list-style-type: none"> (i) One quarterly investment report (1st quarter) was not signed by all Investment Officers, as required by Texas Government Code, Section 2256.023(b)(3). (ii) Three of the four quarterly investment reports (1st, 2nd, and 3rd) were not submitted within a reasonable time after the end of the quarter, as required by Texas Government Code, Section 2256.023(c). (iii) The reports did not include a summary statement for TWDB's pooled fund group, in accordance with guidance set forth in Texas Government Code, Section 2256.023(b)(4)(A)(B)(C) and (7). 	<p>Written internal procedures, and the investment policy as necessary, should be updated to include tracking significant reporting deadlines and should require the completion of a checklist to ensure the quarterly investment reports meet the requirements outlined in Texas Government Code, Section 2256.023. The checklist should be prepared by the assigned staff and reviewed, and approved by a separate individual.</p> <p>Managements Response: <i>Management currently has written deadline tracking mechanisms in place and will continue to review and enhance processes to ensure deadlines are met with regard to timely reporting. We intend to change the format of the quarterly investment report to comply with PFIA requirements and will develop a checklist and quality control process to ensure quarterly reports are accurate.</i></p> <p>Person Responsible: <i>Cindy Demers</i> Implementation Date: <i>May 31, 2016</i></p>
4	<p>We reviewed the fiscal years 2012 and 2013 biennial compliance audit report and the fiscal year 2014 annual review of quarterly investment reports and noted the following:</p> <ul style="list-style-type: none"> (i) The biennial review was performed in accordance with Texas Government Code, Section 2256.005(n) and Section XVII, TWDB investment policy. However, the results were not reported to the SAO by the required deadline. (ii) The quarterly investment reports were formally reviewed and the results were reported to the Board as required by Texas Government Code, Section 2256.023(d) and Section XX, TWDB 	<p>Written internal procedures, and the investment policy as needed, should be updated to include tracking significant reporting deadlines to ensure:</p> <ul style="list-style-type: none"> (i) Compliance audits are performed and results are reported to the SAO by January 1st of each even-numbered year, as required by Texas Government Code, Section 2256.005(n) and TWDB investment policy. (ii) Quarterly investment reports are reviewed at least annually and the results of the review are reported, as required by Texas Government Code, Section 2256.023(d)

No.	Observations	Recommendations
	<p>investment policy. However, the results were not reported to the Board within the “at least annually requirement (365 days from the last review).”</p>	<p>and TWDB investment policy.</p> <p>Managements Response: <i>The Finance Department will update its procedures to include measures to facilitate that the biennial compliance audits and the annual quarterly report reviews are completed. The timely completion of these audits is a joint function of the auditor engaged and the Finance Department.</i></p> <p>Person Responsible: Cindy Demers Implementation Date: March 31, 2016</p>
5	<p>We verified the accuracy of fiscal year 2015 quarterly investment reports by reconciling the holdings data provided by the TTSTC to balances in quarterly reports. Errors were noted in three of the four quarterly reports for fiscal year 2015 as follows:</p> <ul style="list-style-type: none"> (i) The investment portfolio composition graphs included in the 2nd, 3rd, and 4th quarter investment reports were incorrect. (ii) The summary statements of investment holdings included in the 2nd quarter investment report did not reconcile to the holdings data provided by TTSTC. <p>Cash reported in the quarterly investment reports could not be confirmed, as reconciliations of cash and investment balances to independent reports were not consistently performed during the time period of this review.</p>	<p>Written internal procedures, and the investment policy as necessary, should be updated to ensure that the information included in the quarterly investment reports is accurate and complete. This should include, at a minimum ensuring that:</p> <ul style="list-style-type: none"> (i) Quarterly investment reports are prepared by DPM and reviewed for accuracy and completeness by an individual independent of the investment (DPM) area prior to presentation. (ii) Accounting reconciles investments and cash balances monthly. Staff involved in the reconciliation process should be independent of the investment process and reconciliations should be reviewed and approved by supervisory level staff. <p>Managements Response: <i>Management’s internal procedures will be reviewed and updated to include a checklist and quality control review of quarterly investment reports before they are presented to the Board. In addition, management is ensuring procedures are in place to reconcile the investment reports received from the TTSTC to the balances reported on the financial system and the quarterly investment report. This reconciliation will be evidenced by a documented approval process.</i></p> <p>Person Responsible: Cindy Demers</p>

No.	Observations	Recommendations
		Implementation Date: March 31, 2016
6	<p>The investment policy and strategies were reviewed and approved by the Board for fiscal years 2014 and 2015, as prescribed by Texas Government Code, Section 2256.005(e) and Section XVII, TWDB investment policy. However, we found that the policy for fiscal year 2015 was not presented to the Board within the annual requirement (365 days from the last review).”</p>	<p>Written internal procedures should be updated to include tracking significant deadlines to ensure the investment policy and strategies are reviewed and approved by the Board within the annual requirement, as prescribed by Texas Government Code, Section 2256.005 (e) and TWDB investment policy.</p> <p>Managements Response: <i>Management’s internal procedures will be reviewed and updated to include a provision that the annual review of the Investment Policy by the Board will occur by the end of January of each calendar year.</i></p> <p>Person Responsible: Cindy Demers Implementation Date: March 31, 2016</p>
7	<p>We selected fiscal year 2015 portfolio transactions and holdings to determine compliance with the investment policy and adherence to strategies, restrictions, controls and objectives, as defined in the investment policy. We also reviewed the agency’s contractual agreement between TTSTC and TWDB and noted the following:</p> <p>(i) Investment holdings were analyzed by asset type to determine whether funds managed by the Board on behalf of the Authority (TWRFA) were invested in accordance with Section XI (a)(6) of the investment policy. We found that TWDB’s pooled fund group invests in Commercial Paper. Investments included in a pooled fund account are comingled and cannot be allocated to a particular program; therefore, the pool included non-authorized investments.</p> <p>(ii) Investments in TWDB’s pooled fund group were in compliance with Section V of the investment policy, with the exception of two securities with maturities exceeding 360 days. Documentation showing an exemption to this requirement was not provided. Securities are exempt when associated with reserves funds or with specific</p>	<p>Written internal procedures, and the investment policy as necessary, should be updated to incorporate investment management controls. This should include, at a minimum:</p> <p>(i) Establishing procedures to ensure that TTSTC receives a copy of the current investment policy.</p> <p>(ii) Designating an individual to review all trading activity performed on behalf of the agency by TTSTC to ensure activity complies with the contract and the investment policy. The individual’s responsibilities should be clearly defined and formalized. Any compliance violations noted through their review should be reported to the Board.</p> <p>(iii) Ensuring periodic review and approval of the contractual agreement by the Board to make certain the provisions within the contract are still applicable to TWDB’s investments.</p>

No.	Observations	Recommendations
	<p>approval of the Board.</p> <p>(iii) The month-to-month contractual agreement between TTSTC and TWDB had not been reviewed and approved by the Board since its inception in 2006.</p>	<p>Managements Response: <i>The TTSTC has received a copy of the current TWDB Investment Policy as of January 22, 2016. In addition we will develop a reasonable process to assess and report TTSTC performance with regard to compliance with the contract and the TWDB Investment Policy. A review and update of the contract with TTSTC will be completed and in conjunction with the legal department recommendations and a contract update will be presented to the Board.</i></p> <p>Person Responsible: <i>Cindy Demers</i> Implementation Date: <i>June 30, 2016</i></p>

Closing

We would like to express our appreciation to all management and personnel for their cooperation and assistance provided to audit staff during this review. For questions or additional information concerning this audit report, please contact Nicole Campbell at 512.463.7978.

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